

Message Text

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TAGS: PGOV PO
SUBJ: NOBRE DA COSTA'S GOVERNMENT--IMPLICATIONS FOR US INTERESTS

REF: LISBON 6380

SUMMARY: THIS MESSAGE CONTAINS INITIAL EMBASSY APPRAISAL OF THE THIRD CONSTITUTIONAL GOVERNMENT IN THE CONTEXT OF KEY U.S. INTERESTS. WE MAKE NO RPT NO POLICY OR PROGRAM RECOMMENDATIONS AT THIS TIME. AMBASSADOR BLOOMFIELD WILL WANT TO MAKE HIS OWN ASSESSMENT PRIOR TO ANY NEEDED RECOMMENDATIONS, AND IN ANY CASE RECOMMENDATIONS SHOULD AWAIT THE NATIONAL ASSEMBLY'S REVIEW OF THE NEW GOVERNMENT'S PROGRAM. ASSEMBLY ACTION SHOULD BE COMPLETE AROUND THE THIRD WEEK OF SEPTEMBER.

PORTUGAL'S DECOMCRACY HAS SHOWN RESILIENCE AND IS INTACT. WE ANTICIPATE THAT THE NOBRE DA COSTA GOVERNMENT WILL BE WILLING TO PROCEED TOWARD CONCLUSION OF A NEW LAJES AGREEMENT. ON THE ECONOMIC SIDE THE NEW ADMINISTRATION WILL BE DIVIDED OVER THE ISSUE OF ACCELERATED GROWTH VS. STABILIZATION. THE GOVERNMENT WILL GIVE A MAJOR INDICATION OF ITS INTENTIONS WHEN IT PRESENTS THE 1979 BUDGET/INVESTMENT PLAN TO THE ASSEMBLY, PROBABLY IN NOVEMBER. IT MOST LIKELY WILL NOT, HOWEVER, ATTEMPT TO PREPARE A MEDIUM-TERM DEVELOPMENT PLAN. THE GOVERNMENT INTENDS TO ENTER NEGOTIATIONS WITH THE IMF FOR A THIRD TRANCHE AGREEMENT AND MAY SEEK TO REVISE THE CREDIT TARGETS OF THE PRESENT ACCORD. GIVEN ITS LACK OF A POWER BASE, THE GOVERNMENT'S ABILITY TO TAKE SIGNIFICANT ACTION IN OTHER AREAS WILL BE RATHER RESTRICTED, THOUGH IT MAY SEEK TO IMPLEMENT THE AGRARIAN REFORM LAW, IMPROVE PUBLIC ADMINISTRATION, PURSUE NEGOTIATIONS FOR EC ACCESSION, AND ISSUE IMPLEMENTING

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REGULATIONS FOR EXISTING LEGISLATION. END SUMMARY.

1. CONSOLIDATION OF PORTUGUESE DEMOCRACY

A. THE POLITICAL CRISIS HAS NOT CHALLENGED THE SURVIVAL OF DEMOCRACY. THE CONSTITUTION IS INTACT, AND SO ARE THE BASIC INSTITUTIONS OF GOVERNMENT. IN THE ABSENCE OF THE PARTY COOPERATION ESSENTIAL FOR EFFECTIVE PARLIAMENTARY GOVERNMENT, THE PRESIDENT MOVED WITH ASSURANCE TO FIND A CONSTITUTIONAL ALTERNATIVE. DURING THE PROCESS HE REPEATEDLY REAFFIRMED HIS COMMITMENT TO DEMOCRATIC NORMS AND REMINDED THE PUBLIC OF THE CRITICAL ROLE OF THE PARTIES AND THE NATIONAL ASSEMBLY IN THE DEMOCRATIC PROCESS. NOBRE DA COSTA ECHOED THESE REMINDERS AT HIS SWEARING IN. THE MILITARY, FOR THEIR PART, RIGOROUSLY STAYED OUT OF THE PROCESS. PORTUGAL'S DEMOCRATIC STRUCTURE HAS SHOWN RESILIENCE IN THE FACE OF ACERBIC CONFLICTS BETWEEN POLITICAL LEADERS AND PARTIES.

B. IN THE LONGER TERM SERIOUS TESTS REMAIN. THE PARTIES WILL HAVE TO LEARN TO COOPERATE IF THE GOVERNMENT IS TO BE STABLE, IF IT IS TO COPE EFFECTIVELY WITH THE MAJOR ECONOMIC PROBLEMS, AND IF PUBLIC FAITH IN THE

PARTIES AND IN DEMOCRATIC INSTITUTIONS IS TO BE SUSTAINED
OVER THE LONGER TERM. ESPECIALLY IF THERE IS NO
EFFECTIVE ACTION ON THE ECONOMIC FRONT, WIDESPREAD
DISSATISFACTION COULD BECOME SERIOUS BY THE TIME OF
THE 1980 ELECTIONS AND THE SUBSEQUENT EXPECTED
CONSTITUTIONAL REVIEW.

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C. NOBRE DA COSTA CAN RUN A SHORT-TERM (6 MONTHS)
GOVERNMENT OF REASONABLE EFFICIENCY AND EFFECTIVENESS

ON THE BASIS OF EXISTING LEGISLATION. FOR ANY KIND OF
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LONG-TERM ACCOMPLISHMENTS, NOBRE DA COSTA (OR A FOLLOW-ON GOVERNMENT) WILL NEED EFFECTIVE SUPPORT IN THE ASSEMBLY. REDUCTION OF TENSIONS BETWEEN THE PRESIDENCY AND THE SOCIALISTS (MARIO SOARES) IS ONE KEY FACTOR. THE ESTABLISHMENT OF A STABLE MAJORITY IN THE ASSEMBLY LOOKS TO BE HARD TO GET, BUT IT IS A TOP AGENDA ITEM FOR THE PARTIES, THE PRESIDENT AND PROBABLY THE PRIME MINISTER.

2. LAJES NEGOTIATIONS: WE EXPECT THIS GOVERNMENT, UNDER PRESSURE FROM THE PRESIDENT, TO PROCEED WITH THE LAJES NEGOTIATIONS. PREVIOUSLY, FRICTIONS BETWEEN THE CENTRAL AND REGIONAL GOVERNMENTS REPEATEDLY BLOCKED COMPLETION OF A NEW LAJES AGREEMENT. THE FACT THAT THE NEW ADMINISTRATION HAS NO SOCIALIST SUPPORT, AND THEREFORE IS NOT AUTOMATICALLY SUSPECT TO THE AZOREAN POLITICAL LEADERS, MAY FACILITATE CONCLUSION OF AN AGREEMENT. AN AGREEMENT, MOREOVER, WOULD HELP PRIME MINISTER NOBRE DA COSTA TO DEMONSTRATE HIS DECISIVENESS AND TO PROJECT AN ACTIVIST IMAGE. ALTHOUGH HE MIGHT ENCOUNTER SOME DIFFICULTY OBTAINING ASSEMBLY APPROVAL BECAUSE OF INTER-PARTY MANEUVERING, WE DO NOT EXPECT THESE DIFFICULTIES TO BE VERY SERIOUS SINCE BOTH THE PS AND CDS HAVE ALREADY ACCEPTED THE SUBSTANCE OF THE AGREEMENT.

3. ECONOMIC STABILIZATION:

A. EMBASSY OFFICERS HAVE WORKED CLOSELY WITH SEVERAL OF THE NEW MINISTERS, INCLUDING VAZ PORTUGAL, ALMEIDA PINA, GONCALVES RIBEIRO AND, OF COURSE, SILBA LOPES. IN MOST CASES THE APPROACH OF THESE NEWLY-NAMED MINISTERS CLOSELY CORRESPONDS TO OUR OWN. THIS MEANS, IN GENERAL, A MORE PROFESSIONAL MANAGERIAL APPROACH TO PUBLIC PROBLEMS, INCLUDING A GREATER INCLINATION TO DECENTRALIZE ADMINISTRATION, A GREATER OPENNESS TO ADMINISTRATIVE
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REFORM, AND LESS MISTRUST OF THE PRIVATE SECTOR.
B. TWO MAJOR FACTORS WILL COLOR THE NEW GOVERNMENT'S APPROACH TO THE ECONOMIC STABILIZATION PROGRAM: THE GROWTH BIAS OF SEVERAL KEY MINISTERS AND THE GOVERNMENT'S WEAK POLITICAL BASE. THOSE MINISTERS DRAWN FROM THE NATIONALIZED COMPANIES MAY HAVE DIFFICULTY FUNCTIONING WITHIN THE RESTRICTIVE FRAMEWORK OF A STABILIZATION PROGRAM WHICH SEEKS TO RESTRAIN THE VERY INDUSTRIES THEY HAVE LONG SOUGHT

TO NURTURE (PETROLEUM, PETROCHEMICALS, STEEL). THE DESIRE TO PROTECT "THEIR" FINANCIALLY-TRoubLED ENTERPRISES WILL CONFLICT WITH THE NEED TO MEET THE IMF-AGREED CREDIT TARGETS. AT THE SAME TIME, THE LACK OF A STRONG POLITICAL BASE WILL LIMIT THE GOVERNMENT'S ABILITY TO RESIST GROWING PRESSURES FROM SUCH GROUPS AS THE LABOR UNIONS, GOVERNMENT ENTERPRISES, AND SMALL BUSINESS ASSOCIATIONS TO EASE THE STABILIZATION PROGRAM, AND ESPECIALLY THE CREDIT RESTRICTIONS.

C. 1979 BUDGET/INVESTMENT PLAN: THE 1979 BUDGET AND PUBLIC INVESTMENT PLAN SHOULD REVEAL THE GOVERNMENT'S APPROACH TO THE PRINCIPAL ECONOMIC ISSUES. THOSE PROPOSALS MAY NOT BE READY FOR PRESENTATION TO THE ASSEMBLY BY THE OCTOBER 15 DEADLINE, BUT CONTINUANCE OF DR. RAMALHEIRA AS SECRETARY OF STATE FOR THE BUDGET SUGGESTS THEY COULD BE READY BEFORE THE END OF NOVEMBER. SHOULD THE POLICIES OUTLINED THEREIN DIVERGE SUBSTANTIALLY FROM THOSE OF THE SECOND CONSTITUTIONAL GOVERNMENT, THE ASSEMBLY COULD SIMPLY DELAY PASSAGE OF THE BUDGET LAW. IN THAT CASE, THE GOVERNMENT WOULD BE RESTRICTED TO THE 1978 BUDGET AUTHORIZATIONS UNTIL ADOPTION OF THE NEW BUDGET.

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D. MEDIUM TERM PLAN: THE NOBRE DA COSTA GOVERNMENT DOES NOT INTEND TO PREPARE A MEDIUM TERM PLAN. EVEN BEFORE THE FALL OF THE SOARES GOVERNMENT, USILVA LOPES HAD EXPECTED THAT THE GOP WOULD BE UNABLE TO TAKE THE NECESSARY POLICY DECISIONS AND PREPARE THE DOCUMENTATION BY MID-OCTOBER. NOW THE GOP FACES EVEN GREATER CONSTRAINTS, I.E., IT HAS LESS TIME TO MEET THE OCTOBER DEADLINE, FORMULATION OF A HOMOGENOUS POLICY MAY BE MORE DIFFICULT, AND THE ADMINISTRATION DOES NOT WISH TO PRESENT A PROGRAM WHICH IT DOES NOT EXPECT TO BE IN OFFICE LONG ENOUGH TO IMPLEMENT. SILVA LOPES APPARENTLY HOPES TO NEGOTIATE A THIRD TRANCHE AGREEMENT WITH THE FUND ON THE BASIS OF THE 1979 BUDGET/ INVESTMENT PLAN.

E. IMF NEGOTIATIONS: NOBRE DA COSTA, DESPITE SOME CRITICAL COMMENTS ABOUT THE PRESENT GOP-IMF AGREEMENT, HAS AFFIRMED PORTUGAL'S NEED TO SEEK AN AGREEMENT WITH THE FUND FOR 1979. SILVA LOPES WILL RAISE THIS POSSIBILITY WHEN HE VISITS WASHINGTON IN LATE SEPTEMBER TO ATTEND THE ANNUAL FUND/WORLD BANK MEETINGS. NOBRE DA COSTA'S IMMEDIATE CONCERN, HOWEVER, IS THE CREDIT RESTRAINTS OF THE PRESENT AGREEMENT. MANY OF HIS ADVISORS ARE PRESSING FOR EASIER CREDIT, MORE INVESTMENT AND A HIGHER GROWTH RATE. ALTHOUGH SILVA LOPES IS RESISTING THIS TREND, THE GOVERNMENT MAY SEEK TO RENEGOTIATE THE CURRENT CREDIT TARGETS. IF IT FAILS IN SUCH AN ATTEMPT, IT WILL BE SORELY TEMPTED TO CIRCUMVENT THOSE CEILINGS. THE MEANS FOR SUCH EVASION APPARENTLY EXIST. THE STABILIZATION PROGRAM CONTAINS EXPLICIT TARGETS FOR THE BANKING SYSTEM'S NET DOMESTIC CREDIT AND NET FOREIGN LIABILITIES, AS WELL AS INDICATIVE TARGETS FOR THE MONETARY BASE. IT DOES NOT, HOWEVER, CONTAIN EXPLICIT TARGETS FOR MONEY SUPPLY OR FOR CREDIT

FROM GOVERNMENT NONBANKING INSTITUTIONS. THE GOVERNMENT
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COULD CONCEIVABLY HELP FINANCE OUTLAYS OF PUBLIC AND
PRIVATE ENTERPRISES BY USING PART OF THE \$450 MILLION IN
PRIVATE LOANS RECENTLY OBTAINED BY THE TREASURY. SUCH
FINANCING WOULD PRESUMABLY NOT VIOLATE THE LETTER OF THE
IMF AGREEMENT, BUT IT COULD SPARK A LEVEL OF ECONOMIC
ACTIVITY THAT WOULD BE INCONSISTENT WITH THE BALANCE OF
PAYMENTS TARGET. SILVA LOPES HAS ALREADY COMMUNICATED WITH
THE FUND ON THIS POSSIBILITY.

F. AGRARIAN REFORM: THE ADMINISTRATION WILL PROBABLY
SEEK TO REVERSE THE SECOND CONSTITUTIONAL GOVERNMENT'S
GO-SLOW IMPLEMENTATION OF THE AGRARIAN REFORM LAW. MORE
LAND THAT WAS IMPROPERLY SEIZED BY WORKERS WILL LIKELY BE
RETURNED TO FORMER OWNERS. NOBRE DA COSTA, WHO PROMISED TO
BECOME PERSONALLY INVOLVED, MAY EVEN HOPE TO ENFORCE THE
AGRARIAN REFORM LAW MORE VIGOROUSLY THAN DID MINISTER
BARRETO. PROVIDED ORGANIZED OPPOSITION DOES NOT BECOME
TOO SEVERE, THE GOVERNMENT MAY BE WILLING TO TAKE OTHER
DIFFICULT MEASURES TO RESTORE PRODUCTIVITY TO THE ALENTEJO,
E.G., REDUCE CREDIT TO UNPRODUCTIVE COOPERATIVES. SUCH
A POLICY WOULD UNDOUBTEDLY SPARK VERY STRONG OPPOSITION
FROM SEVERAL INTERESTED SECTORS, MOST NOTABLY THE PCP, THE
LABOR UNIONS AND THE ALENTEJO COLLECTIVE FARMS. WHETHER
THE GOVERNMENT COULD WITHSTAND SUCH OPPOSITION REMAINS TO
BE SEEN, BUT IT WOULD CERTAINLY POINT TO THE DISASTROUS
HARVESTS OF THE PAST TWO YEARS AND TO THE URGENT ECONOMIC
NEED TO IMPROVE AGRICULTURAL OUTPUT.

G. USG BILATERAL ASSISTANCE: IN ECONOMIC DEVELOPMENT
TERMS, THE NOBRE DA COSTA GOVERNMENT PERHAPS HAS MORE
COMPETENT AND EFFECTIVE MINISTERS THAN ITS PREDECESSOR.
HOWEVER, AS A TRANSITION GOVERNMENT WITHOUT A POLITICAL
BASE, IT MAY BE ABLE TO DO LITTLE MORE THAN MAINTAIN THE
STATUS QUO. IN SUCH A CASE, THE PROGRESS WE MADE IN
SEVERAL AREAS WITH THE SECOND CONSTITUTIONAL GOVERNMENT
COULD BE LOST (E.G., HOUSING AND URBAN PLANNING, AGRI-
CULTURE, NATIONAL HEALTH, ADMINISTRATIVE REFORM).

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H. OTHER ECONOMIC ISSUES:

(1) COMPENSATION- THE GOVERNMENT'S INNER CIRCLE SYMPATHIZES
WITH INVESTORS WHO, THREE YEARS AFTER THE POST-REVOLUTIONARY
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NATIONALIZATIONS, HAVE RECEIVED NO COMPENSATION. THAT
ATTITUDE, REINFORCED BY EXPECTATIONS THAT COMPENSATION
WILL SPARK INVESTMENTS AND BY PERSONAL RELATIONSHIPS WITH
MANY OF THE BENEFICIARIES, WILL ENCOURAGE THE GOVERNMENT
TO IMPLEMENT THE COMPENSATION LAW AS EXPEDITIOUSLY AS POSSI-
BLE.

(2) DISINTERVENTION- THE GOP HAS NUMEROUS PRIVATE FIRMS
UNDER INTERVENTION, I.E., THE GOVERNMENT FULLY CONTROLS AND
MANAGES THEM. THE MINISTER OF INDUSTRY DEMONSTRATED, WHILE
HE WAS A SECRETARY OF STATE IN THE FIRST CONSTITUTIONAL
GOVERNMENT, A FIRM DESIRE TO TERMINATE SUCH INTERVENTIONS.
IN HIS RECENT PUBLIC STATEMENTS, NOBRE DA COSTA FIRMLY

REITERATED HIS INTENTION TO END THESE INTERVENTIONS AND TO IMPLEMENT THE LAW PROVIDING COMPENSATION TO THE FORMER OWNERS OF NATIONALIZED FIRMS.

4. PORTUGAL'S EUROPEAN TIES: RELATIONS WITH THE EC
AS A RESULT OF THE POLITICAL CRISIS, GOP PREPARATIONS FOR THE SCHEDULED OCTOBER MEMBERSHIP NEGOTIATIONS WITH THE EUROPEAN COMMUNITY HAVE GROUND TO A HALT. NOBRE DA COSTA WILL PURSUE PORTUGAL'S ACCESSION, BUT THE CHANGE IN GOVERNMENT AND THE POLITICAL UNCERTAINTY WILL LIKELY CAUSE SOME DELAYS. MINISTER OF FINANCE AND PLANNING SILVA LOPES DOES NOT PLAN TO CONTINUE AS CHAIRMAN OF THE GOP COMMITTEE DEALING WITH THE EC. HE WILL INVITE FORMER FINANCE MINISTER VITOR CONSTANCIO TO REASSUME THE CHAIRMANSHIP; CONSTANCIO WILL PROBABLY ACCEPT, BUT HE HAS NOT YET DECIDED. FURTHER, INFLUENTIAL PRIVATE ASSOCIATIONS LIKE CIP(CONFEDERATION OF PORTUGUESE INDUSTRY) AND CAP (CONFEDERATION OF PORTUGUESE FARMERS), WHILE NOT OPPOSED TO EVENTUAL EC MEMBERSHIP, HAVE BEEN HIGHLIGHTING PROBLEMS WHICH EC INTEGRATION WILL CAUSE FOR PORTUGAL. NOBRE DA COSTA WILL HAVE TO WEIGH THE CONCERNS OF THESE POTENTIAL

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POLITICAL SUPPORTERS AS HE DEVELOPS HIS NEGOTIATING POSTURE VIS-A-VIS THE NINE. WHEN FORMAL NEGOTIATIONS DO BEGIN, PORTUGAL MAY HAVE TO ANSWER ASSERTIONS RAISED BY THE PORTUGUESE POLITICAL PARTIES DURING THE HEAT OF THE SUMMER CRISIS THAT CONSTITUTIONAL NORMS HAVE NOT BEEN FULLY FOLLOWED. SOME EC MEMBERS COULD EXPLOIT THOSE ASSERTIONS, REGARDLESS OF THEIR VALIDITY, TO DELAY NEGOTIATIONS ON PORTUGAL'S ENTRY INTO THE COMMUNITY.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: GOVERNMENT REFORM, FOREIGN RELATIONS, REPORTS, FOREIGN POLICY POSITION, INTELLIGENCE ASSESSMENTS
Control Number: n/a
Copy: SINGLE
Draft Date: 30 aug 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978LISBON06392
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: X3
Errors: N/A
Expiration:
Film Number: D780353-1180
Format: TEL
From: LISBON
Handling Restrictions: n/a
Image Path:
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Line Count: 476
Litigation Code IDs:
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Message ID: af4d9a67-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 9
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 LISBON 6380
Retention: 0
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Review Content Flags:
Review Date: 20 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1812810
Secure: OPEN
Status: NATIVE
Subject: NOBRE DA COSTA\S GOVERNMENT--IMPLICATIONS FOR US INTERESTS
TAGS: PGOV, PO, US, (DA COSTA, NOBRA)
To: STATE
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/af4d9a67-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014